



COMPANY

47-51 33rd Street
Long Island City, N. Y.

April 21, 1939

To the Stockholders of PEPSI-COLA COMPANY:

By order of the Board of Directors, we are submitting to you the Consolidated Balance Sheet of the Pepsi-Cola Company and its Subsidiaries as at December 31, 1938, and the Consolidated Income and Profit and Loss and Earned Surplus Statement for the year ended December 31, 1938, together with Notes, Comments and Certificate as prepared and submitted to your Board by Klein, Hinds & Finke, Certified Public Accountants, appointed by the Chancellor of the State of Delaware to make the audit.

ARTHUR T. VANDERBILT

Chairman

JOSEPH J. KLEIN, C. P. A.
MYRON A. FINKE, C. P. A.
FRANK E. FIELD, C. P. A.
WALTER A. LESE, C. P. A.
MAURICE AUSTIN, C. P. A.
LEONARD PRICE, C. P. A.

ALBANY
WASHINGTON

CABLE ADDRESS "KLEINAUDIT"

KLEIN, HINDS & FINKE

CERTIFIED PUBLIC ACCOUNTANTS

19 WEST 44TH STREET

NEW YORK

To the Board of Directors
of Pepsi-Cola Company:

We have made an examination of the books and records of Pepsi-Cola Company and its domestic subsidiaries (except Pepsi-Cola Bottling Co. of California) and of Pepsi-Cola Bottling Co. of Cuba, S.A., for the year ended December 31, 1938. On the basis of such examination, and on the basis of reports received from firms of independent chartered accountants with respect to Pepsi-Cola Company of Canada Limited and Pepsi-Cola Limited (England) (the net assets of both of these foreign corporations representing approximately 15% of the total consolidated net assets, and the net profits thereof representing approximately 12% of the total consolidated net profits), we have prepared the accompanying Consolidated Balance Sheet as at December 31, 1938, and the related Consolidated Income and Profit and Loss and Earned Surplus Statement for the year ended on that date, which statements give effect to various adjustments to the book figures found necessary as the result of our examination.

In connection with our examination, we examined or tested accounting records of the companies and other supporting data and, where possible, obtained information and explanations from officers and employees of the companies. We also made a general review of the accounting methods employed and of the operating and income accounts for the period covered by the financial statements, but we did not make a detailed audit of the transactions.

In our opinion, based upon such examination and reports, the accompanying Consolidated Balance Sheet and the related Consolidated Income and Profit and Loss and Earned Surplus Statement, as supplemented by the explanatory notes contained in the appended Notes to Financial Statements, fairly present, in accordance with accepted principles of accounting, the consolidated financial position of the companies as at December 31, 1938, and the consolidated results of the operations for the year ended on that date.

NEW YORK, N. Y., MARCH 28, 1939.

KLEIN, HINDS & FINKE

Certified Public Accountants.

PEPSI-COLA COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INCOME AND PROFIT AND LOSS
AND EARNED SURPLUS
FOR THE YEAR ENDED
DECEMBER 31, 1938

GROSS PROFIT ON SALES		\$7,342,201.04
Selling, general and administrative expenses		<u>3,216,029.28</u>
OPERATING PROFIT		\$4,126,171.76
Special legal and other expenses (including litigation of <i>Loft, Incorporated v. Charles G. Guth et al</i>).	\$117,497.31	
Less other income, net	<u>49,658.15</u>	<u>67,839.16</u>
NET PROFIT BEFORE PROVISION FOR INCOME TAXES		\$4,058,332.60
Provision for federal and Canadian income taxes		<u>818,000.00</u>
NET PROFIT (excluding Pepsi-Cola Bottling Co. of California—see note (5)(b))		\$3,240,332.60
Earned surplus, January 1, 1938		
(after giving effect to audit adjustments)	\$3,686,621.01	
Less provision for unpaid dividend declared in 1936 with respect to 10,000 shares of capital stock which were the subject of litigation; the litigation was finally determined in 1939	<u>20,000.00</u>	<u>3,666,621.01</u>
EARNED SURPLUS, DECEMBER 31, 1938		<u><u>\$6,906,953.61</u></u>

The appended Notes to Financial Statements are an integral part of the above Consolidated Statement of Income and Profit and Loss and Earned Surplus and should be read in conjunction therewith.

PEPSI-COLA COMPANY
CONSOLIDATED
AS
DECEMBER

ASSETS

CURRENT ASSETS:

Cash in banks and on hand	\$ 1,870,904.02
Notes and accounts receivable from franchise bottlers and others for machinery, advances, truck rentals, etc.	183,701.92
Miscellaneous accounts receivable	21,186.83
Merchandise inventories	753,598.68
Investment in Loft, Inc. (11,700 shares), at cost (market value \$100,912.50) . . .	23,400.00
TOTAL CURRENT ASSETS	<u>\$ 2,852,791.45</u>

OTHER INVESTMENTS, ADVANCES AND RECEIVABLES, AT COST:

Pepsi-Cola Bottling Co. of California	125,288.98
Domestic franchise and other bottlers	185,841.03
Employees	40,604.69

FIXED ASSETS:

Property, plant and equipment, at cost, less depreciation	4,524,384.01
Bottles, cases, etc., on hand and in customers' hands, at values not in excess of cost .	620,591.58

OTHER ASSETS:

Machinery held for resale, at cost.	57,350.13
Prepaid insurance and taxes	154,072.03
Advertising materials and miscellaneous assets	31,743.27

TRADE-MARKS, FORMULAS AND GOODWILL (at value placed thereon by the directors of the company in 1931, representing the par value, \$5 per share, of 300,000 shares of capital stock issued therefor, of which 100,000 shares were donated to the company) 1,500,000.00

TOTAL ASSETS \$10,092,667.17

The appended Notes to Financial State
Consolidated Balance Sheet and shou

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BALANCE SHEET

AT

R 31, 1938

LIABILITIES AND CAPITAL

CURRENT LIABILITIES:

Accounts payable	\$ 194,214.87
Accrued expenses:	
Salaries, commissions, bonuses, etc.	88,100.87
Taxes	159,603.44
Reserve for federal and Canadian income taxes on current earnings	818,000.00
Miscellaneous liabilities	35,297.11
TOTAL CURRENT LIABILITIES	\$ 1,295,216.29

(with the exception of an indeterminable amount currently payable for
bottles and cases returnable by customers—see below)

LIABILITY FOR DEPOSITS ON BOTTLES AND CASES RETURNABLE BY CUSTOMERS (an
indeterminable portion of which amount will probably be currently paid in cash)

330,818.78

TOTAL LIABILITIES \$ 1,626,035.07

CAPITAL:

Capital stock:

Authorized 300,000 shares, par value \$5 per share; issued and outstanding 261,486
shares (after deducting 38,514 shares in the treasury) 1,307,430.00

Capital surplus (par value, \$5 per share, of 100,000 shares of capital stock donated to
the company, less discount on the reissuance of some of these shares) 252,248.49

Earned surplus, as per accompanying statement. 6,906,953.61

TOTAL LIABILITIES AND CAPITAL \$10,092,667.17

ments are an integral part of the above
ld be read in conjunction therewith.

PEPSI-COLA COMPANY AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

(1) *Merchandise Inventories:*

Inventory quantities were verified (a) by examination or test of inventory and other accounting records, except as to raw materials aggregating approximately \$50,000, for which such records were not available; (b) by physical count or test of 91% of the merchandise on hand and reconciliation thereof with book records; and (c) by independent confirmation of all merchandise held in independent warehouse, amounting to \$45,762.15. Our examination indicated that the inventory was priced at cost, which was not in excess of market or of prices paid for current purchases, except as to the domestic companies' inventories of manufactured concentrate, finished syrup and finished beverage, which, from such information as was available, appeared to be valued at approximately \$45,000 in excess of cost.

(2) *Other Investments, Advances and Receivables:*

(a) Pepsi-Cola Bottling Co. of California:

The amount shown in the Consolidated Balance Sheet comprises the cost, \$15,000, of 150 shares, stated to represent three-sevenths of the outstanding capital stock of the above company, and \$110,288.98 due on open account. Ownership of the remaining outstanding capital stock is the subject matter of litigation in the California courts, the issue involved being the right of Mr. E. Carey Guth to this stock, for which it is represented that he paid \$20,000 in September, 1938, pursuant to a claimed stock purchase option dated December 17, 1935 (prior to the incorporation of the company). Information as to the net worth of this company as at December 31, 1938, was not available.

The open account was reconciled with the California company's records as at September 30, 1938; such records, however, were not available for comparison as at December 31, 1938. The above-stated balance includes \$28,997.04 of charges which, at September 30, 1938, had not been recorded in the books of Pepsi-Cola Bottling Co. of California; \$27,677.06 of this amount, although originally charged to said company in the books of Pepsi-Cola Company, had, prior to September 30, 1938, been charged off as expenses in the latter's books. In the event that the issue regarding the ownership of four-sevenths of the outstanding capital stock of Pepsi-Cola Bottling Co. of California is determined adversely to Pepsi-Cola Company, there would remain for determination a question of possible increase of the amount due by the former company to the latter on account of past transactions; the amount involved exceeds the net worth of the California company as at September 30, 1938, as shown by its books.

In view of the litigation regarding the ownership of the outstanding capital stock of this company, its assets, liabilities and earnings have not been consolidated in the accompanying financial statements.

(b) Domestic franchise and other bottlers:

Most of these items are of doubtful collectibility, but no reserve has been provided therefor in the company's records, or in the accompanying Consolidated Balance Sheet. While it was not possible from the information available to determine the full extent of the reserve required for the uncollectible portion of these items, it appeared that such reserve should be at least \$100,000.

(c) Employees:

The above includes a balance of \$12,698.17 against Mr. Charles G. Guth, Sr. No effect has been given in the accompanying financial statements to the amount, if any, which may be determined to be due to or from Mr. Charles G. Guth, Sr., or The Grace Company, Inc. of Delaware upon the accounting ordered in the case of *Loft, Incorporated v. Charles G. Guth et al.* if the decision in that case should be affirmed on appeal. There is no basis for expressing a judgment as to the amount of the adjustment which may be involved. At a recent meeting of the Board of Directors of Pepsi-Cola Company, Mr. Charles G. Guth, Sr., jointly on behalf of himself and The Grace Company, Inc. of Delaware, orally asserted a claim of \$5,000,000, "based on profits earned by myself and the Grace Company," and not based on "contract." No comment can be made on the merits of this claim, since supporting data have not been supplied.

There is also included under the above caption the amount of \$27,906.52, indicated by the records to be due from a sales representative. Neither the correctness of this amount nor its collectibility could be determined, because of the unavailability of contract or other supporting data, and the lack of response to requests for confirmation.

(3) *Contingent Liabilities:*

(a) Any liability which may be determined to be due to Mr. Charles G. Guth, Sr., or The Grace Company, Inc. of Delaware, upon the accounting referred to in Item (c) under Note (2), above.

(b) Any liability resulting from, and the legal and other expenses of, pending litigations:

(i) Proceedings for injunction and accounting brought by Coca-Cola Company of Canada Limited against Pepsi-Cola Company of Canada Limited; an appeal by Pepsi-Cola Company of Canada Limited is pending from an adverse decision granting an injunction and damages in the amount of its entire profits since its organization. The amount involved is presumably at least equal to that company's earned surplus, which, at December 31, 1938, exceeded \$1,000,000.

(ii) Litigation pending in the Supreme Court of the State of New York, Queens County, involving counterclaim of Coca-Cola Company against Pepsi-Cola Company, seeking injunctive relief and an accounting.

(iii) Other litigations, involving claims against the company aggregating approximately \$45,000, exclusive of claims which, according to the company's counsel, appear to be fully covered by insurance.

(c) Proposed assessments (less overassessments) of additional federal income and excess-profits taxes for 1936 and 1937, amounting to \$80,024.90, plus interest. Pursuant to extensions granted, federal income tax returns for the year 1938 have not yet been filed, and, of course, have not yet been reviewed.

(d) Various claims, not in litigation, aggregating between \$20,000 and \$25,000.

(4) *Capital Stock:*

Options are alleged to be in existence for the purchase from Pepsi-Cola Company of 20,000 shares of its capital stock, at \$2.50 per share, running in favor of Mr. Charles G. Guth, Jr., and 23,000 shares, at \$1.00 per share, running in favor of Mr. William H. Hoodless.

No effect has been given in the accompanying statements to a subscription to 95% of the capital stock of Pepsi-Cola Bottling Co. of Cuba, S. A., purporting to have been made by Mr. Charles G. Guth; the status of this subscription is undetermined.

(5) *Operations for the year ended December 31, 1938:*

(a) There are included in the accompanying statements, as expenses for the year 1938, certain expenditures and charges, the proper treatment of which may be involved in the accounting referred to in Item (c) of Note (2), above. The principal items of this nature are expenditures of \$90,238.04 (the 1938 portion of a total of approximately \$260,000 expended during the years 1936, 1937 and 1938) incurred in connection with the case of *Loft, Incorporated v. Charles G. Guth et al.*, for which the company claims to be entitled to reimbursement from Mr. Charles G. Guth, Sr., and 1938 bonus and salary paid to Mr. Charles G. Guth, Sr., in the aggregate amount of \$156,749.97.

(b) As hereinbefore stated (Item (a) of Note (2), above), the earnings of Pepsi-Cola Bottling Co. of California have not been included in the accompanying Consolidated Income and Profit and Loss Statement. About May 1, 1938, prior to which the operations of this company resulted in no profits, the method of operations was changed with the result that, thereafter, profits which, under the former method of operations, would have been realized by Pepsi-Cola Company, have been received by the California company instead. The net profit of the California company for the nine months ended September 30, 1938, as shown by its books, after making provision for income taxes and certain adjustments, was approximately \$88,000. Corresponding figures for the entire year 1938 were not available.

